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THE BIG BUSINESS OF SMALLER COMPANIES

APRIL 1981
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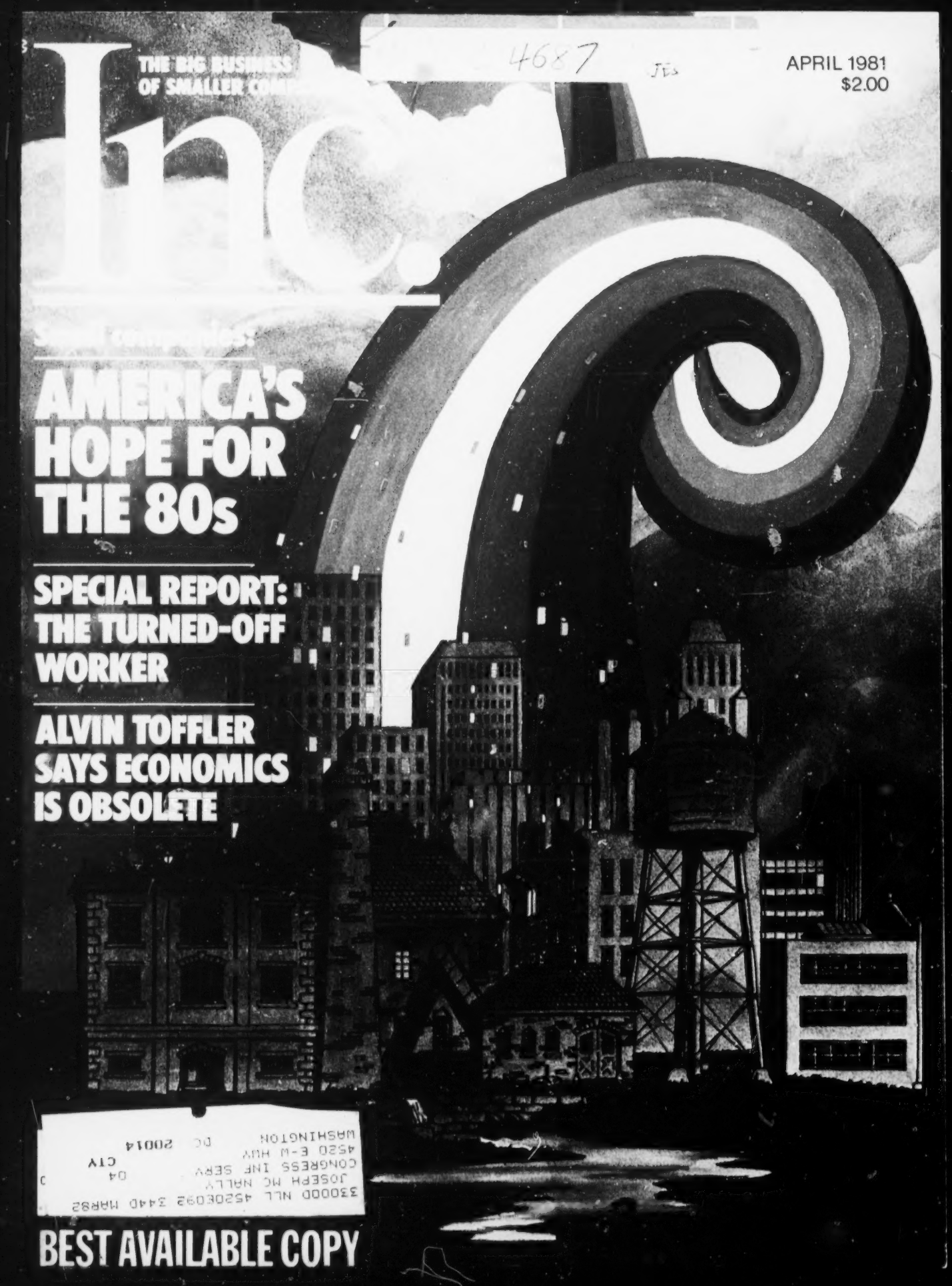
AMERICA'S HOPE FOR THE 80s

SPECIAL REPORT: THE TURNED-OFF WORKER

ALVIN TOFFLER SAYS ECONOMICS IS OBSOLETE



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CONTENTS

DEPARTMENTS

From the editors 7

Letters 10
Earl Graves profile tells positive story; More advice on handling a board of directors; Small company advisers tilting at windmills?; Charity isn't so sweet; The ABCs of Z factor.

Speaking out 16
Rollovers: Not even the tax man loses. So what's taking so long?

Economic issues 18
The inflation fight: Will anyone be around to celebrate the victory?

News & trends 22
Wall Street takes its chances on gambling man; U.S. trade policy a mess, First Daughter protests; Small business benefits from change in economy; For technology, oil, gas, it was a very good year.

At a glance 30

Time out 113
Silks and saddles.

Taxes 118
Reagan presidency: tax changes, yes; a revolution, no.

Legal briefs 120
Legislative intent overrules letter of the law; Sexist workers' comp death benefits barred.

Ideas you can use 122
Put performance into appraisals; Take guesswork out of salary setting; Spell out firm's overtime policy; How to spot the successful people; Insure against overseas losses; Keep posted on trade events; Should you accept damaged freight?

Books 128
Theory Z: making American business more productive.

Personal finance 136
You can retire and have life insurance that keeps working.

Cover illustration
Jeremy Ross

Small companies: America's hope for the '80s
At a time of crisis and disillusionment, the entrepreneur leads the way to economic revival. **34**

Shopsmith pounces on its problems
John Folkerth believes the best way to meet the challenge of fast growth is to attack vigorously. **46**

Inflation: Who's kidding whom?
All too often, the Consumer Price Index is regarded as a true measure of inflation. But it tells only part of the story. **54**

My managers are buying me out
Faced with a classic problem of management succession, this owner found a way to turn his company over to a team of loyal managers. **61**

Special report: the turned-off worker
Why John and Mary won't work: The work ethic is alive, but old motivators are failing. **70**

When workers and companies both win **81**

Where are your receivables right now?
Between invoicing and collecting, valuable cash may be loitering around unproductively. **86**

Economics is obsolete
Alvin Toffler, the author of *Future Shock* and *The Third Wave*, believes that all our basic economic concepts are outmoded. **91**

Making money isn't the religion at Hurco
Instead, the company was founded on old-fashioned spiritual values. **104**

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were generally "prudent," the department would not look into the individual venture-capitalist investments.

After pension funds, major corporations were the largest single group of contributors, investing $118 million in 1980, up significantly from $28 million in 1979. Foreign investors increased their stake from $26 million in 1979 to $53 million in 1980.

SECURITIES

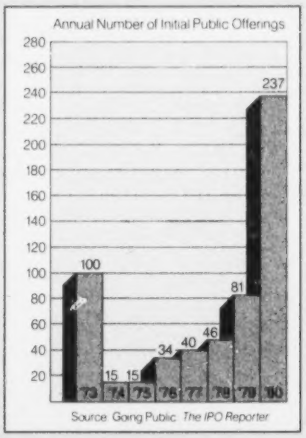
For technology, oil, gas, it was a very good year

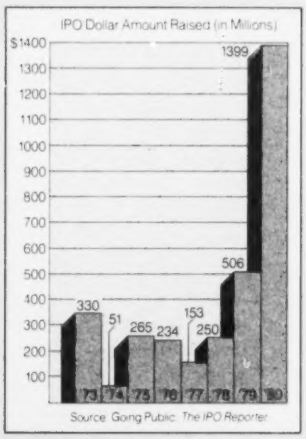
The tremendous rush of technology and oil and gas companies to go public late last year continued to fuel the stock market into 1981. In December alone, almost $400 million—more than was raised than in any year between 1973 and 1978—was invested in new stocks. And, as 1981 dawned, another 150 new stocks were in the Securities and Exchange Commission pipeline waiting to go public.

All in all, 237 companies made initial public offerings last year, raising nearly $1.4 billion in new capital, but on the basis of the backlog, underwriters were already predicting another good year. "The number of issues might be even larger if the market holds up," commented Sanford Robertson, partner of Robertson, Colman, Stephens & Woodman, a San Francisco investment banking firm that specializes in taking technology companies public. "I don't think the market environment is any better," said Robertson. "There's just a lot of catching up going on."

Oil and gas companies outnumbered high technology ventures going public last year; the two categories constituted

AN ASTONISHING SPURT IN INITIAL PUBLIC OFFERINGS





Charts by Geoffrey Hodgkinson

SMALLER COMPANY INITIAL PUBLIC OFFERINGS: JANUARY 1981

Company	Business	Offering Size ($000)	Offering Price $	P/E	12-month sales ($000)	Underwriter
Bellwether Exploration Co.	oil & gas exploration	5,000	5.00	62	1,477	Hanifen, Imhoff Inc.
Dallas Oil & Minerals Inc.	oil & gas exploration	3,500	.10	[a]	[a]	Fitzgerald, DeArman & Roberts Inc.
Diagnostic Retrieval Systems Inc.	computer systems	4,125	10.00	24	10,064	Ladenburg, Thalmann & Co. Inc.
Engineering Measurements Co.	measurement systems	2,475	3.00	17	5,201	Hanifen, Imhoff Inc.
Fidelity Medical Services Inc.	cardiac testing	5,400	3.00[b]	300	491	Patten Securities Corp.
Information Retrieval Systems Corp.	information storage systems	3,600	2.00	[c]	3,714	M. W. Wien & Co.
Intelligent Systems Corp.	color graphic terminals	12,000	16.00	67	14,492	L. F. Rothschild, Unterberg, Towbin/Robinson-Humphrey Co. Inc./Hambrecht & Quist
Inter-Tel Inc.	telephone systems	8,250	12.50	42	10,648	Bache Halsey Stuart Shields Inc./E. F. Hutton & Co. Inc.
ISSC Industrial Solid State Controls Inc.	programmable controls	10,325	14.75	11	33,207	Bache Halsey Stuart Shields Inc.
Lyric Energy Inc.	oil & gas exploration	2,000	.10	[a]	[a]	OTC Net Inc.
Machine Technology Inc.	semiconductor device manufacturing systems	2,450	3.50	32	4,151	Rooney, Pace Inc.
Matrix Science Corp.	environmental electrical connectors	16,000	16.00	21	26,716	Shearson Loeb Rhoades Inc.
Nutri/System Inc.	diet clinics	16,150	19.00	14	23,204	L. F. Rothschild, Unterberg, Towbin

[a]No operating history
[b]Units consisting of two shares and one warrant
[c]Negative earnings
Data: *New Issues*, The Institute for Econometric Research Inc., 3471 N. Federal Highway, Ft. Lauderdale, FL 33306

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the majority of initial offerings.

Another indication of how avid the market was for new issues was the number of start-ups, 131, which raised nearly $400 million. Just over $50 million of that was raised by two start-ups, People Express Airline and American Leisure, an Atlantic City casino company.

—Jonathan Williams

THE ECONOMY

It's a buyer's market for small companies

Owners who want to sell their small businesses will have to settle for less than they would have a few years ago, says business broker Henry M. Thornton, president of Baird Business Associates of Ft. Lauderdale, Fla. Because high interest rates have cut into the earnings of small firms, Thornton says, they are less desirable to buyers, who are themselves strapped by the high rates.

The poor business climate also means that there are more owners seeking to unload their companies, Thornton says. The result is a glut of sellers and a shortage of buyers.

For example, Thornton cites a company that had sales of over $6 million in 1980 and earnings of $950,000. If the firm had been paying interest at the 1979 level, he estimates, its earnings would have been $1.5 million. And if it had not had to borrow at all, its earnings would have hit $2.25 million. Smaller companies typically sell for about four times their net earnings, so the decline in profits makes a big difference.

The long term outlook is bleak, Thornton says. "Even if rates drop," he points out, "no one expects the drop to be permanent."

CAPITAL

The boss is (literally) banking on employees

When Lincoln Contractors Supply Co. of West Allis, Wis., needed a new computer, company president Alfred Knief went to the bank. But by the time the bank was ready to make the $70,000 loan, interest rates had climbed to 16%.

Knief knew he could do better.

"When you're trying to find ways to economize during a recession," Knief says, "you have to use some initiative." So he asked his employees to lend him the money.

When word went out that the company would pay 12% interest on employee loans to the business, 17 of the firm's 23 workers lent Lincoln anywhere from $1,000 to $20,000. Knief accepted the loans as three-day demand notes so that

Dal Bayles

Alfred Knief: His employees beat the bank.

employees could withdraw their money on short notice with no penalty.

In all, the company raised $109,500—enough to pay for the computer, the software, and several smaller outstanding loans. "Now," Knief says, "I like to say that we only owe money to ourselves."

INNOVATION

Inventor invents a way to help other inventors

Inventors who walk into Nicholas Kondur's Denver office in search of help must feel reassured by the 30 silver-framed patents hanging on his wall. But for Kondur the patents were a source of frustration as well as pride. Most of the fruits of his inventions went to his employers, not to him.

"When you see your employer taking out a large number of patents on your work," Kondur says, "you wonder whether maybe your inventiveness is being used up." There must be a way, he figured, to help other inventors while helping yourself.

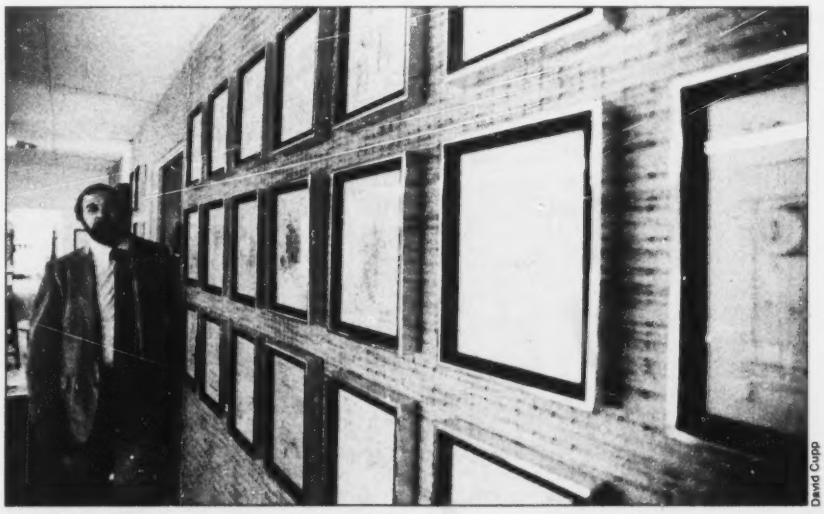
Kondur's frustration led to his latest "invention," a firm that obtains manufacturing or marketing rights to new inventions, in exchange for consulting, testing, or marketing services for the small companies where they were invented. In its third year, 1980, Kondur's International Technology Resources Inc. had revenues of $471,000, up 95% over the previous year. But those figures are deceptive because many of ITR's clients are start-up companies strapped for cash, so ITR often takes stock in return for its services. While much of the stock is restricted, and is traded on the volatile Denver "penny" market (see INC., May 1980, page 32), the paper gains on the value of the stock recently topped $2 million.

Kondur is no stranger to fast growth. When he was executive vice-president and later chairman of LRC Corp., a leading matrix printer manufacturer, the company's sales spurted so fast it ranked 58 on the 1979 INC. 100. It ranked even higher, 17, in profitability among the firms in the INC. 100. Kondur left LRC when he and the board fell out over business strategy.

Among the most promising ventures in ITR's portfolio of innovation, Kondur says, are a radioactive tracer drug for cancer detection, a portable inflatable solar energy heater for use by hunters or recreational vehicle owners, and a fast, one-step microfiche copier.

Kondur sees three or four inventions or business schemes a week. "I have a basic rapport with inventors," he says. "I love to hear them tell how they'll sell 30,000 units next year. In fact, some of them will. But it's difficult to tell which ones."

—Harrison L. Moore



David Cupp

Nicholas Kondur and his patents: He built his business on a rapport with inventors.

SMALL COMPANIES: AMERICA'S HOPE FOR THE 80s

At a time of crisis and disillusionment, the entrepreneur leads the way to economic revival.

Col. Elijah Dreadnaught
The Society for Surviving
the Coming Collapse
Atop the Redoubt
Jordan, Maine

Dear Colonel:

It's been two years now since that day in Washington Square when you gave your "Prisms of Fire" speech that blended Kondratyev Wave theory with astrology to foretell the coming economic collapse. "Why work?" I asked myself. "It's all over anyway." So I quit my job as a back office clerk with Smyth, Bigsby & Purnell, investment bankers, and joined the Society. I sold my car and gave you the money for my share of the dried food you're storing in the horse barn at the Redoubt. I even agreed to serve as one of your "border guards," patrolling the real world for some sign that the end was at hand. You know I've been vigilant, so I was hurt by your recent letter that accused me of "whistling in the dark." Can I help it if the only news I find seems good?

Unfortunately, you're likely to find my news today worse than ever. Although you've told me many times that entrepreneurship is dead, I have to report that entrepreneurs don't know it. In fact, it's beginning to look like their time has come. A renaissance, so to speak. I'm talking about the big picture now, boss; about the ascendancy of the American legend in a time of crisis; about a change in the social consensus from "What's good for General Motors is good for the country" to "What's good for small business is good for the country."

I'm sorry to have to tell you this, but the activities of this rowdy bunch of entrepreneurs are being seen as an antidote to the calamity we've been waiting for. President Reagan has already called them "heroes," and to give you an idea of how things are looking better for them, consider these facts: More money has been invested in venture capital limited partnerships than ever before; in 1980, the total investments by small business investment companies broke all previous records; the number of companies offering stock to the public for the first time in 1980 was the greatest in eight years; since the White House Conference on Small Business, nearly 20 states have passed special legislation or formed committees to encourage small business; and, in the closing months of 1980, the number of new business incorporations hit an all-time high. In a word, boss, we may very well be at a historic turning point that will make the Armageddon you've predicted look like a battle in a sandbox.

Editor's note: Associate editor Lucien Rhodes came to work recently with a mysterious and lengthy letter he claims he found tucked into an economics text at the Boston Public Library. Despite the letter's dubious origins, we think its author arrived at an important conclusion. Rhodes checked out the letter's accuracy with the help of assistant editor Cathryn Jakobson.

Let me give you my conclusions. Entrepreneurship has entered a renaissance on the strength of three important forces: the amount of money available to new and infant businesses; new directions in government policy; and changes in society's attitudes. From each of these viewpoints, it has become increasingly clear that entrepreneurship gives you more bang for your buck.

Money: Institutional money managers—the people who invest the really big money—have a tough time keeping the rates of return on their portfolios ahead of double digit inflation. But venture capital offers significantly higher returns than traditional outlets such as the stock market. While common stocks have historically returned between 7% and 9% annually through appreciation and dividends, most venture capitalists expect an annual return of at least 20% to 25%. So, like water finding its own level, money is gushing into the venture capital pool.

Government policy: Evidence is mounting that small companies are more innovative and create more jobs per dollar of investment than their larger counterparts. To governments at all levels troubled by declining growth in productivity, rising unemployment, and squeezed tax bases, promoting and encouraging small business looks like a good bet. Of course, the bureaucracy does move slowly—but many people feel it's taken some important first steps toward small business.

Society's attitudes: Changes in the intellectual, moral, and cultural climate of an era—what you call the zeitgeist, boss—are always tough to pin down. As you know, Americans have always been a fickle lot. But let me give you Jack Neises, general partner of Charles River Partnership, a venture capital limited partnership. He hears from the zeitgeist daily. "There's been a societal change that has rekindled the entre-

Jeremy Ross

preneurial drive. People no longer like the idea of being loyal corporate soldiers, then retiring with a gold watch. Many of them are saying, 'Why not take the chance? I'll never get another one.' I don't think this was true in the 1960s when inflation wasn't so bad. Then people with a vested interest in a pension plan could point to something. But inflation has changed that type of thinking. Now they have to ask, 'What's it going to be worth when I retire anyhow?' "

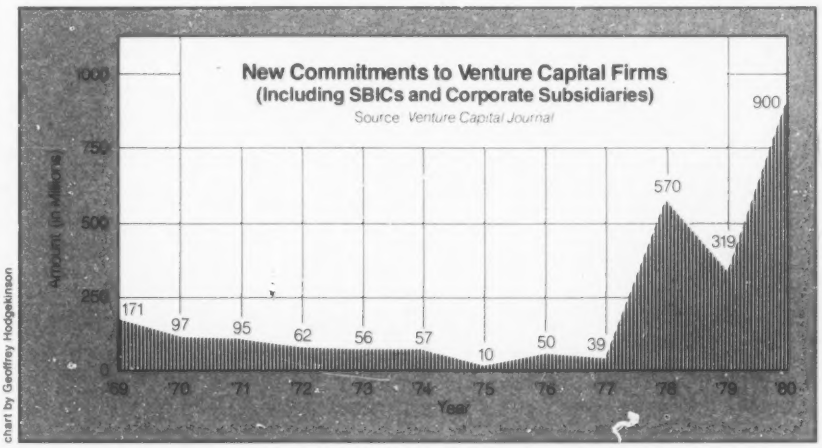
When you put these things together, boss, it's a pretty heady brew that gives me crazy thoughts about real economic growth, Eisenhower, and driving around in a '57 Chevy with the top down. Oh sure, there are still problems, but I ask you: Where's the big economic collapse and rioting in the street that you predicted in your book, *Grab What You Can and Run*? How long do I have to wait, anyway?

Just in case you're thinking I made this whole thing up, let me tell you how I sleuthed it out. One afternoon I was studying your monograph, *Down, Down, Down: The Road to Ruin*, in which you examine how economics got to be called a science—a hoax you compared with other notable hoaxes, such as the Tulip Mania, the South Sea Bubble, and the Salad Oil Swindle. Then I got that old tingling sensation in the nape of my neck. You know, boss, it's that tingling I always get when something big is about to happen.

I remembered a Department of Labor study that said that after two decades of decline, the number of people who classify themselves as self-employed rose 25% between 1972 and 1979, and that the number of people who classify themselves self-employed but have incorporated their businesses increased by 41% between 1976 and 1979. The study concluded that the baby boom generation "placed a higher premium on being able to work for themselves than did prior generations." And I remembered a baby boomer pal of mine, misguided though he was, who turned his back on the big money two years ago to start a small publishing company, saying, "If I don't do it now, I never will. Besides, working for somebody else is a pain in the butt." Boss, I tell you, it was cosmic. I saw legions of entrepreneurs asking relatives for money, and the smiling face of prosperity rising in the background. "Something's going on here," I said to myself.

I decided to get a second opinion. I went to see Royal Little in Providence. If anybody has a finger on the economic pulse, it has to be Little, who is 85 years old. He has some 60 years of continuous business experience. In 1923, he founded the Special Yarns Corp., later called Textron. In the '50s, he won for himself the intriguing title, "Father of Conglomerates."

Little didn't waste any time. He hit me right where I lived. "Now's the time to be starting your own business," he said.



"Why do you say that?" I stammered.

"Look at this," he said. "There's more money available now than I've ever seen before." Remember, a "before" from Little covers a lot of ground. Here are the numbers he slid across the table:

Capital committed to private venture capital firms (mil.)

Source	1978	1979	1980
Pension funds	$ 32	$ 53	$190
Major corporations	22	28	118
Individuals and families	70	39	112
Endowments and foundations	19	17	99
Insurance companies	35	7	85
Foreign investors	38	26	53
Total	$216	$170	$657

Source: *Venture Capital Journal*

This is actually a snapshot of money gushing into the venture capital pool. Can't you see the sluice gates open? Notice that between 1979 and 1980 there are big jumps in every category. Not only is something going on here, but smart money has already spotted it. Entrepreneurship is hot.

Two days later, I was sitting in Stanley Pratt's office trying to learn more about venture capitalists. Pratt collects figures like capital commitments and publishes them in his trade journal, *Venture Capital Journal*. "In 1980," he said, "the amount of new money flowing into venture capital reached the highest point in the industry's history." Here's the graph he showed me to illustrate his point:

These numbers are bigger than the ones you saw earlier because they include small business investment companies (SBICs) and corporate venture capital subsidiaries.

Even though the total amount of money invested in venture capital—currently estimated at $4.5 billion—is only a tiny part of the great pool of money consumed annually by small business, many observers feel it's one of the best indicators of the strength of entrepreneurship. It has been called a "pilot light for the economy." And due to the vagaries of available statistics, it is one of the few areas that can be quantified with a reasonable degree of accuracy. Venture capital has the added virtue of being a direct connection between money and entrepreneurs. And Reagan himself said that entrepreneurs are the ones "who create new jobs, wealth, and opportunity."

I have to admit, the view from these heights is impressive. But equally interesting to me is the forbidding wasteland that had to be crossed to get here: the years between 1969 and 1978. This turbulent period is critical to understanding the resurgence of venture capital and

the quickening rise of entrepreneurship. Moreover, the after-shocks from these years are shaping government policy today.

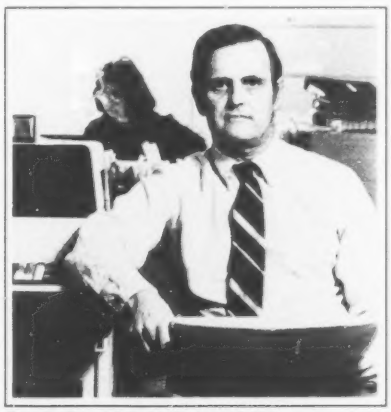
There was, of course, the 1973 oil embargo, the 1973–74 credit crunch, and the 1974–75 recession, but the real story lies elsewhere. In 1969, the capital gains tax rate was increased from 25% to 49% for individuals. That altered the economics of venture capital investing so radically that the industry nearly died. In 1975, new commitments of $10 million barely left breath on the mirror. Then in 1978, the capital gains tax was reduced to 28%, and new commitments were almost 15 times greater than the year before. "The change in the taxation on capital gains," Pratt says, "was the major cause of the resurgence of venture capital funds."

At the same time, entrepreneurs got a shot in the arm. "It changed the risk to reward ratio to favor entrepreneurs," venture capitalist Jack Neises will tell you, "and made it twice as profitable for potential entrepreneurs to leave big companies."

I hope you're beginning to see why I'm getting nervous about your prediction of the coming collapse. The sequence of events is pretty clear, isn't it? Reduced taxes bring out more venture capital money which brings out more entrepreneurs who then create innovations and more jobs and ultimately real economic growth. We both know more tax cuts are on the way, so I ask you, what will become of our Society, boss?

But like you've always said, "What you see in the numbers, you've got to see in the trenches—or else throw out the numbers." So that's where I went next and I have to admit, the trenches never looked better. More money, more deals, and deals of higher quality keep the energy level very high—kind of a financial Woodstock.

Several of the venture capitalists I spoke with had either recently funded new partnerships or were in the process of doing so. The line of institutional investors waiting to get in goes around the block. In many cases, it appears that the only constraint on the amount of money that a given venture capitalist can raise is the size of the partnership's investment staff. And while many agree that the cut in the capital gains rate has fueled investor interest, they also point out several other reasons. Morton Collins, general partner of DSV Associates in Princeton, N.J., thinks that institutional investors have more confidence in venture capital partnerships. "The last decade has proved venture capital investing," he says. "It's inherently risky, but the results during this time period have shown certain investors—like pension funds and endowment funds—that the risk-reward ratio is acceptable."



Stanley Pratt: A boost from tax laws

There's a saying in venture capital that may help you understand what Collins means: "Lemons ripen first; plums take longer." Remember that back in 1969 and 1970 new venture capital commitments fell off nearly 50%. You already know one of the reasons why this happened, but let me give you another one: 1969 was a good year for lemons.

Between 1963 and 1969, venture capital investing was shedding its image as the plaything of very rich families. As part of this process, institutional investors took their first tentative stab at newly formed partnerships. The stock market was booming and investment attitudes in general were expansive. But venture capital was still unfamiliar territory and early investors were edgy. One fact that wasn't very well understood was that most venture capital portfolios have a gestation period of between 7 and 10 years. In other words, that's usually how long it takes before you can start counting plums.

In 1969, some of the lemons began showing up, and many institutional investors took it as a sign that venture capital simply was too rich for their blood. They took their money and went elsewhere. On top of this came the stock market break in the early '70s that effectively buried the cult of high-risk, high-performance investing that typified the "go-go" years of portfolio management in the '60s. But 10 years later, after credit crunches and recessions, many of the partnerships formed in the late '60s were still around and, sure enough, there were some plums underneath the lemons. The significance of the achievement didn't go unnoticed by institutional investors looking on from the sidelines. Janet A. Hickey, manager of investment research and head of venture capital commitment at the General Electric Pension Trust, summarizes the feelings of most institutional investors: "You've got teams of people now who are cycle-tested, who have managed venture capital during the past decade, which were turbulent times for financial assets. Confidence in venture capital partnerships has grown."

In addition to greater confidence, venture capitalists point out that institutional investors look to partnerships for so-called second plays. A pension fund, for example, by virtue of its investment in a partnership, gets a chance to study new, emerging technologies. Later, when individual companies go public, the pension fund is already well prepared to take positions in the common stock. Similarly, corporate investors use this "window" on a new technology to spot potential acquisition candidates.

Still, the most frequently mentioned reason for the boom is that investing in venture capital offers superior rates of return over the long term. Here's Peter A. Brooke, managing partner of Boston-based T.A. Associates: "I raised $60 million last June and it might just as well have been $100 million. Money managers have seen one thing: that they can do better in venture capital than they can in stocks. And they want to get in on the action."

That's the supply side of the picture, boss. Discouraging, isn't it? Unfortunately, the demand for funds is equally brisk. Every one of the venture capitalists I spoke with said that more entrepreneurs were knocking on their doors than ever before.

"It's definitely more active than in the past," said Dan Gregory of Greylock Management Corp. in Boston. "In 1980, for example, we made

about 10 investments, but we seriously considered another 100 and glanced at another 200." Thomas J. Perkins, senior partner at Kleiner, Perkins, Caufield & Byers in San Francisco, said, "We're seeing 5 to 10 times as many deals now than we did at the low point in 1974."

But it's not only the number of deals professionals find so encouraging, it's also the quality behind them. "More management talent is accompanying the ideas than ever before," said Timothy M. Pennington, general partner of Brentwood Associates in Los Angeles. "These entrepreneurs have more experience behind them, their ideas are more carefully thought out, and the business plans they submit are much more sophisticated than in the past." Although most partnerships are concentrating on backing high technology ventures, there is still a lot of opportunity for companies not involved in high tech industries."

Boss, if this were just a case of a few more entrepreneurs knocking on the doors of the American Dream, even a few hundred more, I swear I'd be blissfully unconcerned. I would take it to be one of the last gasps of a failing economy that you predicted in your pamphlet, *Who's Laughing Now?* Unfortunately, the rise of entrepreneurship has been gaining momentum for a lot longer than I ever imagined. And Milton Stewart confirmed it for me. Stewart was chief counsel for advocacy at the U.S. Small Business Administration until he became editor of INC. magazine.

"The dominant facts in the 1950s," Stewart said, "were the memories of the Depression and World War II. These two things focused society's attention on the seeming desirability, even inevitability, of bigness in government and in business. The Depression and Keynesian economics encouraged bigness in government, and the industrial resources required to win the war emphasized big business.

"But as a people, we're raised to resist concentrated power of any sort. It's something we take in with our mother's milk. So there we were, expecting benefits from bigness, but not liking it either.

"Most people were ambivalent until the 1960s when the ambivalence turned aggressively negative and antibigness on issues like the environment and Vietnam. More and more, students began to complain that the universities were only preparing them for big corporations. They began to press faculties for courses on venture capital and entrepreneurship. Soon after, government attitudes began to change as the economy began to stumble on inflation, on declining rates of productivity growth, on fewer patents and innovations, on domestic market shares lost to foreign competitors. The most visible example of this change in government attitude was its holding the White House Conference on Small Business. All these things are interrelated and together they have, over the last 10 to 15 years, moved society toward entrepreneurship. It's a powerful tide, and it's still rising."

> "Entrepreneurship is on the rise, and it's a direct consequence of the 1960s."

I suspect President Reagan has been hearing the same story. At least Candidate Reagan was reading from the same book. In a position paper sent to the National Small Business Association prior to the election, Reagan opened with the following sentence: "The success of our economy is critically dependent upon the preservation of real opportunity for small business." And later he talked about reducing income taxes "to encourage entrepreneurship and investment."

Still, some people point out that there are no guarantees that Candidate Reagan and President Reagan will turn out to be one and the same person. Campaign promises, they say, are just that: promises. You have to keep your eye on what's actually being done. And to some observers of the small business environment, recent developments are a little distressing. For example, Herbert Liebenson, president of the NSB, is already worried about promises getting lost in the new policy shuffle. He calls the report from the President's Small Business Issues Task Force, generally regarded as the first indication of small business policy under the new Administration, a "conflicting document that poses more questions than it answers." On the one hand, he says, it offers some specific recommendations that are strongly pro–small business such as the rollover tax deferral on capital gains reinvested in small business. On the other hand, it instructs the Administration not to "deliberately favor one form of business over another."

Liebenson then quickly ticks off a list of issues, all of which, he says, put small business at a disadvantage relative to big business. "Let's face it," he says, "the only way you can compete equally is if you start off equally. My job is to get a fair share for my constituency, and it's just too soon to tell what the Administration is going to do."

While Robert B. Reich, director of policy planning at the Federal Trade Commission, agrees that entrepreneurship and small business is enjoying a renaissance, he prefers to call it a "minirenaissance" and thinks that it will be short-lived. "All the signs point to the Reagan Administration going back into the big-business-is-the-best type of policy and attitude," he says.

Reich believes that President Reagan's actions, such as eliminating the Economic Development Agency, accelerating depreciation rates, and increasing defense expenditures, indicate that big business will once again have more political clout than small business. And it is precisely this relative political power, he says, that has determined the fate of small and big business at any given moment throughout history. As Reich sees it, the fundamental tension between the two go all the way back to Thomas Jefferson and Alexander Hamilton.

Jefferson wanted to preserve a decentralized market economy, but Hamilton preferred the economies of scale attendant to big business and big banking. Jefferson didn't want to sacrifice the kind of innovation and political decentralization that came from small enterprises for the growth and large scale investment that Hamilton promised. The fight was on, but the first title bout didn't occur until the 1880s as midwestern agrarian discontent began to incite small business and the middle class against the big trusts. The result was the Sherman Antitrust Act of 1890—a TKO scored by small business.

Small business continued in the ascendancy until World War I when

the war effort pushed big business into the political limelight and kept it there through the '20s. After the Crash and Depression, neither big nor small business had an advantage. In fact, Franklin D. Roosevelt tried to mollify both with the National Industrial Recovery Act, which was soon declared unconstitutional.

At the same time, small business watched the spread of chain stores, particularly in food retailing, with growing apprehension. Apprehension turned to outright fear, and a united small business community began to scream for protection. The result was the Robinson-Patman Act—another TKO for small business that signaled balmy days until the onset of World War II. Then, small business's World War I experience was repeated all over again.

The primacy of big business continued through the '50s. In fact, it wasn't until the early '60s that small business began to attract government concern over small business set-asides, antitrust, and military procurement. Even though the Nixon Administration wasn't a small business champion, there was some concern for small business throughout the '60s right up to the present day. "But now," Reich says, concluding his analysis, "I see the tide turning to big business again with the Reagan Administration."

Boss, for a while, my mood brightened noticeably, but then I remembered that several people, Milton Stewart for one, sharply disagree with Reich's assessment of the relative political power of small business and the entrepreneur. Not only will Reagan be goaded forward by his own statements on small business, they say, he will also be moved by the not inconsiderable momentum let loose by the White House Conference on Small Business. And underlying it all is the power of a new social consensus that wants the entrepreneur to succeed. What's more, the White House Conference has already produced some very real gains that can't be ignored.

The 96th Congress, for example, took five recommendations from the Conference and made them law: the Omnibus Small Business Act, the Regulatory Flexibility Act, the Equal Access to Justice Act, the Paperwork Reduction Act, and the Patent Policy Reform Act. The Conference also inspired a sense of aggressive solidarity among small business people that promises to keep up the pressure on government lawmakers.

"I've been fighting guerilla warfare for small business ever since I started my own on a kitchen table 11 years ago," says Robert E. Carr, chairman of the National Unity Council. "They say there are 14 million of us in small business. Now that's a lot of votes. We're going to make the 1980s the decade of small business and the entrepreneur."

Jack Neises: A new risk-reward ratio

Carr also points out that the frontal assault of small business is being further strengthened by high caliber support from an often overlooked source—state governments. Even government officials concede that state governments are setting a faster pace than the federal government. "There may be more going on at the state level than at the federal level," says John Satagaj, special projects counsel in the Office for Advocacy at the Small Business Administration. "The activity there reflects small business's new ability to get organized at the grass roots level. There can be more of a continuous personal relationship between entrepreneurs and their state governments than between entrepreneurs and the federal government. After all, they're neighbors."

Satagaj says that since the White House Conference, at least 10 governors have established advisory councils on small business and almost a dozen state legislatures have created committees on small business. In addition, a whole flock of bills are pending in various state legislatures that would give small business a break in several areas including capital formation and retention, regulation, and taxation.

Brother, did I have a headache after I heard this news. And it got progressively worse during the next few days as I digested equally sanguine views served up by academics and entrepreneurs alike. Although each view was slightly different, I began to see a single story line emerging. After World War II, the entrepreneur was inadvertently bumped into a ditch as big business and big government sped by. The entrepreneur lay in that ditch for years. Passersby weren't particularly interested in pulling him out because the idea he stood for—namely a vigorous self-assertion that enabled him to abandon security and take on frightening risks—simply wasn't fashionable. It was also unnecessary because, at the time, big business appeared eminently qualified to guide you to the good life. And big government was on hand to ensure that you could enjoy that good life tranquilly.

Nor could the entrepreneur pull himself out of the ditch, because he had no political influence or confraternity to aid him. Some rescue attempts were made over the years that followed but, judging from the results, they were only halfhearted. Finally, in the mid-'60s, the entrepreneur, or more precisely, the entrepreneurial idea, was released. Students everywhere were celebrating the right of the individual to fashion his own highly personal imprint on life, unfettered by what they perceived to be the purely self-serving and largely misguided motives of big business and big government. The entrepreneurial businessperson was simply swept up in the tide.

"Entrepreneurship is on the rise," says Harold C. Livesay, author of *American Made*, a study of several famous entrepreneurs. "And it's a direct consequence of the 1960s. Until then, big corporations looked like the ultimate answer to a lot of society's problems, but that changed as the self-reflection of the '60s generation began to identify goals that were not being met by giant organizations. What looked like omniscience on the part of big business often proved to be very wide of the mark." Even so, many of the '60s generation who are now becoming today's entrepreneurs got their training and a significant part of their savings by working for large corpora-

tions. And while they were accumulating the experience they needed to fulfill the promise of the '60s, another curious thing happened: These future entrepreneurs began to hear that they really mattered in the great economic scheme of things.

The National Science Foundation funded a study of major innovations introduced between 1953 and 1973 and found that small firms produced about 4 times as many innovations per research and development dollar as medium-sized firms and about 24 times as many as large firms.

In 1978, Dr. Edwin V. W. Zschau, chairman of the board of Systems Industries in Sunnyvale, Calif., appeared before the Senate Select Committee on Small Business urging the members to reduce the capital gains tax rate. Dr. Zschau presented a startling study done by the American Electronics Association that clearly demonstrated the importance of small, newly formed companies.

He argued that the tax rate should be reduced because it would encourage the flow of equity capital into new business, which would then have a multiplier effect on new jobs, tax revenues, and other categories. For example, he took 77 electronics companies that in 1976 had an average age of four years and showed that every $100 of equity capital invested in each of these companies generated $70 in export sales, $33 in R&D expenditures, $15 in federal corporate income taxes, $5 in state and local taxes, and $15 of federal personal income taxes through the jobs created by the initial investment. He also found that in 1976, companies less than five years old had an employment growth rate 115 times that for more mature companies. Zschau's research is generally thought to have played a key role in the subsequent decision to cut the capital gains tax rate.

In 1979, David L. Birch of the Massachusetts Institute of Technology, in a vastly expanded study, confirmed the importance of young, small firms in creating new jobs. Birch studied the activities in the early '70s of 5.6 million businesses that accounted for roughly 82% of all private sector employment. Birch found that two-thirds of the total employment growth came from companies with fewer than 20 employees and that most of those companies were less than five years old. "It appears," he said, "that it is the smaller corporations, despite their higher failure rates, that are aggressively seeking out opportunities, while the larger ones are primarily redistributing their operations."

Not surprisingly then, potential entrepreneurs, now armed with business experience, some personal savings, a heightened self-esteem, and still cherishing the '60s idealism, began to leave corporate security to strike out on their own.

"I was determined to make an investment in myself," says Bill Foster, a 36-year-old entrepreneur who typifies the quality of thought currently loose in the land. Foster quit his job as vice-president of software development at Data General in July 1979, and in May 1980, founded Stratus Computer Inc. with $1.7 million in venture capital seed money.

> It has become increasingly clear that entrepreneurship gives you more bang for your buck.

"I always thought about starting my own company," he says, "but at the same time, I always had a lot of security where I was. I was getting promotions and raises regularly. But in 1979, I suddenly understood very clearly that the worst possible thing that could happen to me in my lifetime would be to wake up when I was 70 years old and have to say, 'You never even tried.' "

Foster's company is less than a year old. There are no sales yet at this Massachusetts-based manufacturer of minicomputer systems, but, says Foster, "Quitting was the best decision I ever made."

And Tony Muller, vice-president of finance and one of the founders of two-year-old Econics Inc. agrees. In 1978, Muller left his job at Spectra-Physics to join two friends, also from a large company, to start Econics. The California-based company makes sensor controllers for large boilers that monitor the chemical composition of gases and the efficiency of combustion to reduce energy costs.

"Entrepreneurship is all over the place," Muller says "It's an offshot of the mood of the '60s. People are more concerned with their individuality. The way I look at it, you take a very high risk if you decide to stay with the management of a large company. It's a lot riskier than starting your own small business. If you stay, you're dependent on so many things for upward mobility: You've got to do a good job, wait until the right people die off, hope that the company does well, beat out the other 400,000 people who want the same position, and pray there's not a sudden management change just as you get in line for a promotion.

"You want to see the ideal job?" he adds. "Well, come to work with me in the morning."

There you have it, boss: the renaissance of the entrepreneur, the ascendancy of small business. I know it's going to catch on. People want to see it: a slightly battered American legend to save the day in a time of crisis. It's very American. Whenever someone is giving me a piece of the big think, I close my eyes and pretend it's being played out on the silver screen. If, near the end, I hear the bugle call of the charging U.S. Cavalry, I know it will draw big crowds. I hear the bugles now.

Boss, it looks like the Society is going to be drowned in the depths of the venture capital pool, abused by federal and state government, and publicly humiliated by the zeitgeist.

Oh, you're probably going to tell me to go back and scratch up some bad news any way I can. But it's not going to do any good. I don't think the folks hear it anymore. It's like Philador Bigsby, the famous money manager, used to tell me when I worked at the brokerage firm. "Human nature," he said, "is always sitting at a desk with a pile of good news on the right and a pile of bad news on the left. Human nature reads from one pile at a time. That's called a trend, and you get creamed bucking the trend."

I hate to tell you, but about an hour ago human nature started reading from the good news pile. You may call it wishful thinking, so I'll close with a comment from Harold Livesay, the author. "The funny thing about the economy," he says, "is that wishing works." □

Regards,

Rodney Rudderless

NOTE

ONLY THE FOLLOWING PAGES OF THIS

PUBLICATION HAVE BEEN FILMED

Cover 1, p. 3, 51-56, 58,

161-162.